

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 ICA-11 AID-05 EB-08 NSC-05  
SS-15 STR-07 OMB-01 CEA-01 CIAE-00 COME-00 FRB-03  
INR-10 NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01 L-03  
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R 111623Z SEP 78  
FM AMEMBASSY ROME  
TO SECSTATE WASHDC 5790  
TREAS DEPT WASHDC  
INFO EC COLLECTIVE

C O N F I D E N T I A L SECTION 1 OF 2 ROME 16947

USEEC ALSO FOR EMBASSY; PARIS ALSO FOR USOECD

E.O. 11652: GDS  
TAGS: EFIN,IT  
SUBJ: EMBASSY'S COMMENTS ON PANDOLFI'S PLAN

REF: ROME 16278

1. SUMMARY. PANDOLFI'S THREE-YEAR ECONOMIC PROGRAM IS, IN OUR JUDGMENT, A GOOD BASIS ON WHICH THE POLITICAL FORCES (POLITICAL PARTIES, LABOR UNIONS AND INDUSTRIALISTS) CAN BUILD AN EFFECTIVE DEVELOPMENT STRATEGY. AS IT NOW STANDS, HOWEVER, THE DRAFT PROPOSAL HAS SOME MAJOR WEAKNESSES. POLITICAL PARTIES, LABOR UNIONS AND INDUSTRIALISTS HAVE STATED THAT THEY WILL MAKE SPECIFIC SUGGESTIONS DURING DISCUSSIONS WITH THE GOVERNMENT WHICH ARE PRESENTLY UNDERWAY. BOTH THE PRIME MINISTER AND THE TREASURY MINISTER HAVE INDICATED THAT THEY ARE OPN MINDED AND THAT CHANGES WILL BE ACCEPTED BEFORE THE PROGRAM IS FORMALLY PRESENTED TO PARLIAMENT BEFORE THE END OF THE YEAR. THE REAL DIFFICULTY, AS WE SEE IT, IS NOT SO MUCH AGREEMENT ON A SPECIFIC SET OF GOALS BUT FORGING THE POLITICAL CONSENSUS REQUIRED TO  
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MAKE THE HARD CHOICES FACING THE COUNTRY. AS LONG AS THE POLITICAL FRAMEWORK REMAINS THAT OF A FRAGILE TRUCE, HOWEVER, LOWEST-COMMON DENOMINATOR POLITICS CAN BE EXPECTED TO PREVAIL. THE PRESENT FIVE-PARTY PARLIAMENTARY MAJORITY HAS SO FAR BEEN INCAPABLE OF LEGISLATING REDUCTION IN PUBLIC SECTOR EXPENDITURES AND ELIMINATING SOME OF THE ANOMALIES OF THE "SCALA MOBILE"--THE TWO AREAS IDENTIFIED

BY PANDOLFI AS BEING RESPONSIBLE FOR THE ECONOMY'S PROBLEMS. THEREFORE, WHETHER PANDOLFI'S PROPOSAL SUCCEEDS WHERE PREVIOUS EFFORTS HAVE FAILED REMAINS TO BE SEEN. END SUMMARY.

2. AS IS OFTEN THE CASE WITH DOCUMENTS OF THIS NATURE PUBLISHED IN ITALY, AN INORDINATE AMOUNT OF SPACE IS ALLOCATED TO ANALYZING THE PAST. FOLLOWING THIS TRADITION, ABOUT HALF OF PANDOLFI'S DOCUMENT IS AN ANALYSIS OF ITALY'S MOST RECENT ECONOMIC DIFFICULTIES. THIS ANALYSIS FOCUSES ON THE INTERNAL CAUSES OF INFLATION, UNEMPLOYMENT AND BALANCE OF PAYMENTS DIFFICULTIES. IT SPECIFICALLY HIGHLIGHTS THE PUBLIC SECTOR DEFICIT AND LABOR COSTS AS BEING THE TWO BASIC PROBLEM AREAS. THE DOCUMENT DESCRIBES THE CURRENT ECONOMIC SITUATION AS INHERENTLY UNSTABLE. IT, THEREFORE, INDICATES THAT THE GOAL OF ECONOMIC POLICY IS TO GUIDE THE ECONOMY'S MOVEMENT IN A SUSTAINABLE DIRECTION. IN ORDER TO PUT THE ECONOMY ON SUCH A COURSE, THE GOVERNMENT MUST ACT IMMEDIATELY TO CORRECT THE STRUCTURAL CAUSES OF INSTABILITY. OTHERWISE, THE ANALYSIS CONTINUES, THE ECONOMY WILL REMAIN IN THE VICIOUS STOP/GO CYCLE OF RECENT YEARS.

3. AS AN ANALYSIS OF ITALY'S ECONOMIC DIFFICULTIES, THE DOCUMENT MAKES AN IMPORTANT CONTRIBUTION. IT BECOMES WANTING, HOWEVER, WHEN IT TRIES TO PRESCRIBE A STRATEGY  
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TO PUT THE ECONOMY BACK ON A NON-INFLATIONARY COURSE.

A. THE SUGGESTED PRESCRIPTIONS ARE NOT SPECIFIC ENOUGH. FOR INSTANCE, WITH THE EXCEPTION OF RECOMMENDED REDUCTIONS IN CURRENT EXPENDITURES FOR 1979 (INCLUDING PENSION BENEFITS), THE DOCUMENT REALLY FAILS TO SHOW HOW THE SHIFT OF RESOURCES OUT OF CURRENT PUBLIC EXPENDITURES AND INTO PUBLIC INVESTMENTS IS TO TAKE PLACE DURING THE NEXT THREE YEARS. THIS IS A MAJOR WEAKNESS SINCE, IN THE ABSENCE OF A SIGNIFICANT REDUCTION IN SUCH EXPENDITURES AS A PROPORTION OF TOTAL EXPENDITURES, TOGETHER WITH A CONCOMMITENT INCREASE IN PUBLIC SECTOR INVESTMENTS, THE ECONOMY WILL NOT BE ABLE TO RESUME A FASTER, SUSTAINABLE, GROWTH RATE.

B. WHILE IT HAS CORRECTLY GIVEN TOP PRIORITY TO PUBLIC SECTOR DEFICIT AND LABOR COSTS, THE DOCUMENT IS INCOMPLETE IN INDICATING PROBLEM AREAS REQUIRING REMEDIAL ACTION. PERHAPS MOST IMPORTANTLY, THERE IS NOT ANALYSIS

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OR PROPOSED REMEDIES FOR THE PROBLEMS FACING THE STATE PARTICIPATION SECTOR NOR THE APPROPRIATE ROLE OF THE STATE IN THE ECONOMY. SIMILARLY, THERE IS NO DISCUSSION OF THE AGRICULTURE SECTOR PROBLEMS AND WHAT CAN AND SHOULD BE DONE TO REDUCE THE VERY LARGE FOOD DEFICIT. THE PLAN ALSO FAILS TO ADDRESS THE PRESSING STRUCTURAL AND FINANCIAL PROBLEMS OF INDUSTRY, PARTICULARLY THOSE OF THE CHEMICAL STEEL AND TEXTILE SECTORS.

C. THE GOAL OF KEEPING REAL WAGES CONSTANT DURING THE NEXT THREE YEARS IS BASED ON THE "OBJECTIVE" OF 500 TO 600 THOUSAND NEW JOBS. THE PLAN DOES NOT STIPULATE HOW THESE JOBS WILL BE CREATED. GIVEN THE STRESS ON PUBLIC INVESTMENTS AS A WAY TO RELAUNCH THE ECONOMY, HOWEVER, IT WOULD APPEAR THAT THE PUBLIC SECTOR WOULD HAVE TO GENERAL MOST OF THESE JOBS. THE PROBLEM WITH SUCH A STRATEGY, IS THAT THIS MAY LEAD IN THE LONG RUN TO A GROWING RATHER THAN DECLINING PUBLIC SECTOR DEFICIT SINCE IT IS ALWAYS EASIER TO INCREASE THAN TO REDUCE EXPENDITURES. ANOTHER PROBLEM WITH THIS EMPLOYMENT TARGET IS THAT IT IS BASED ON AN AMBITIOUS GAIN IN ITALY'S MARKET SHARE OF WORLD TRADE DURING THE NEXT THREE YEARS.  
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ITALY'S EXPORTS ARE FORCAST TO RISE BY 6.5 PERCENT A YEAR AS COMPARED WITH AN ESTIMATED RISE IN WORLD TRADE OF 4.0 TO 4.5 PERCENT. IF LABOR UNIONS ARE TO AGREE TO THE RECOMMENDED WAGE STRATEGY, THEY WILL NEED A MORE

"SOLID" COMMITMENT ON JOBS--SOMETHING THAT NEITHER THE GOVERNMENT NOR INDUSTRY CAN MEANINGFULLY PROMISE.

4. DESPITE THESE WEAKNESSES, WE BELIEVE THAT PANDOLFI'S PAPER PROVIDES A GOOD BASIS OF DISCUSSION WITH THE POLITICAL PARTIES, LABOR UNIONS AND INDUSTRY. WHAT WILL BE REQUIRED IS A FLESHING OUT OF THE BROAD OUTLINES CONTAINED IN THE PROPOSAL INTO PROPOSED SPECIFIC MEASURES, ARRIVING AT THE NECESSARY POLITICAL CONSENSUS ON THESE MEASURES AND THEN TRANSLATING THIS INTO A LEGISLATIVE PROGRAM.

5. IF RECENT EXPERIENCE PROVIDES A GUIDE, THERE ARE AMPLE GROUNDS FOR SCEPTICISM. SINCE MID-1977 THERE HAS BEEN A "PROGRAMMATIC ACCORD," WHICH WAS REVISED LAST MARCH WHEN THE PRESENT ANDREOTTI GOVERNMENT WAS FORMED; THIS WAS SUBSEQUENTLY TRANSLATED INTO "ANDREOTTI'S 147 POINTS;" THEN CAME THE PANDOLFI "MINI-BUDGET" IN AMY; AND NOW A "THREE-YEAR PLAN." IN THE MEANTIME, VERY LITTLE HAS BEEN DONE. THE POLITICAL PARTIES SEEM TO AGREE ON THE OBJECTIVES OF ECONOMIC POLICY; THERE IS ALSO GENERAL AGREEMENT ON THE MEANS TO MEET THOSE OBJECTIVES, AS LONG AS THE DISCUSSIONS REMAIN ON A GENERAL PLANE. THE PROBLEMS ARISE WHEN THESE THINGS HAVE TO BE TRANSLATED INTO CONCRETE LEGISLATION. OBJECTIVES BECOME SIDETRACKED OR WATERED DOWN WHEN THE POLITICAL FORCES HAVE TO COME TO GRIPS WITH THE POLITICAL COST OF REDUCING PUBLIC SECTOR EXPENDITURES AND TAKE MEASURES TO ELIMINATE SOME OF THE ANOMALIES OF THE "SCALA MOBILE." CONFIDENTIAL

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SO FAR, THE POLITICAL FRAMEWORK HAS BEEN TOO INHERENTLY FRAGILE TO OVERCOME THIS HURDLE. WHAT IS NEEDED, THEREFORE, IS NOT A NEWER OR BETTER PLAN BUT THE POLITICAL WILL TO DO WHAT EVERYBODY AGREES MUST BE DONE. WHETHER PANDOLFI'S PLAN CAN SUCCEED WHERE PREVIOUS PROGRAMS HAVE FAILED REMAINS TO BE SEEN. HOWEVER, AS LONG AS THE POLITICAL STALEMATE BETWEEN THE PARTIES PREVAILS, LOWEST COMMON DENOMINATOR CONSENSUS POLITICS WILL CONTINUE TO BE THE ORDER OF THE DAY. HOLMES

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## Message Attributes

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